ST 97-27
Tax Type: SALES TAX
Issue: Enterprise Zone (Exemptions)
Statute of Limitations Application

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS

THE DEPARTMENT OF REVENUE	**)**	
OF THE STATE OF ILLINOIS	**)**	
	)	**Docket #**
v.	**)**	
	)	**IBT #**
TAXPAYER, INC.	**)**	
Taxpayer	**)**	

RECOMMENDATION FOR DISPOSITION

Appearances: Gerri Papushkewych, Wolfson & Papushkewych, for TAXPAYER, Inc.; Charles Hickman, Special Assistant Attorney General, for the Illinois Department of Revenue.

Synopsis:

The *prima facie* case of the Illinois Department of Revenue (the "Department") consisting of three correction of returns or determination of tax due was established by the admission of the documents into evidence as Dept. Ex. No. 1. At issue herein, is the question of whether TAXPAYER, Inc. (the "Taxpayer") was the end user of tangible personal property, in this case, steel incorporated into various construction projects. The taxpayer attempted to avail itself of the enterprise zone exemption found in the Retailer's Occupation Tax Act at 35 **ILCS** 120/5k. The Department, in its Audit Corrections and/or Determinations of Tax Due, imposed use tax upon the taxpayer, pursuant to their interpretation of that Act. The Department asserts that the taxpayer is not a retailer and is, in fact, the end user of the tangible personal property and therefore, not entitled to the exemption. The taxpayer has requested an abatement of penalties due to the confusion about the issue of the enterprise zone exemption in the Champaign County area. The taxpayer has also requested

that the interest rate be lowered to more accurately reflect the rate imposed by the Internal Revenue Service. It is recommended the decision of the Director of the Department be that the taxpayer is liable for the use taxes imposed, that the interest rate applied by the Department is statutory and therefore not amendable, and that the penalties imposed in this matter be abated for reasonable cause.

Findings of Fact:

1. The *prima facie* case of the Department, consisting of three Audit Correction and/or Determinations of Tax Due, was established by the admission into evidence of the documents as Dept. Ex. No. 1. The liability established is for use tax due on receipts in the amount of $145,750.00, plus the additional penalties, for the period July 1, 1988, through October 31, 1994.[1]

2. The taxpayer is a contractor/supplier for structural steel, miscellaneous steel and metal decking and bar joists for various projects across the States of Illinois and Indiana. (Tr. pp. 5-6)

3. Sometime in the 1980's, the taxpayer became aware of the enterprise zone established in Champaign County in the Champaign-Urbana area. (Tr. p. 6)

4. The City of Champaign, by Council Bill number 85-352, established by ordinance, an enterprise zone on December 17, 1985, which included portions of both the City and Champaign County. (Taxpayer Ex. No. 6)

5. During a portion of the period at issue, the City of Champaign would issue a certificate of eligibility for projects within the enterprise zone, stating that the project qualified for a sales tax exemption. (Tr. p. 7)

6. On August 2, 1990, the taxpayer was notified by the City of Champaign-Champaign County Enterprise Zone that the City of Champaign would no longer be

[1]. The Department, in its brief, refers to two Notices of Tax Liability issued against the taxpayer and the protest filed by the taxpayer. As the Notices and protest are not of record, all references to them must be discounted. Neither did the taxpayer introduce the Notices in reference to the Department's computation of interest.

issuing Certificates of Eligibility for projects within the Enterprise Zone due to a recent change in sales tax reform legislation. (Taxpayer's Ex. No. 1)

7. The fact that items are exempt from sales tax due to an enterprise zone exemption would be included in the specifications that the taxpayer received for a particular project. (Tr. pp. 6-7)

8. The contract that the taxpayer would receive from the contractor would also state that the project was located in the enterprise zone. (Tr. p. 7)

9. In 1989, the taxpayer was involved in the Trade Center South project, located in Champaign, Illinois. Trade Center South is a large office building and an attached Raddison Hotel. (Tr. p. 8)

10. The group, 51 Associates, owned the project. The taxpayer was to supply the structural steel, miscellaneous steel and metal deck, and bar joists for the project. The taxpayer was responsible for making sure that the steel was installed properly. (Tr. pp. 9, 19)

11. The president of the taxpayer was also a partner of 51 Associates. (Tr. pp. 8-9)

12. The taxpayer subcontracted with TAXPAYER Contractors for the labor portion of the installation of the steel. (Tr. pp. 11, 19)

13. The steel was never sold to TAXPAYER Contractors. (Tr. p. 21)

14. A negotiated contract was entered into between the taxpayer and 51 Associates. (Tr. p. 9)

15. The owner of the taxpayer was also a partner in 51 Associates. As such, if he had known that the taxpayer did not qualify for the enterprise zone exemption, he could have increased the contract amount to recover the cost of the tax from 51 Associates. The negotiated bid was not competitive. (Tr. pp. 8, 13-14)

16. The taxpayer manufactured part of needed steel for the project and purchased some from Ozark Steel. Ozark Steel is located in Farmington, Missouri. The taxpayer issued resale certificates to Ozark Steel for the purchases, based

upon the belief by the taxpayer that he was a retailer and the sales were exempt from tax due to the enterprise zone exemption. (Dept. Ex. No. 2; Tr. pp. 11, 25-27)

17. The taxpayer was under the impression that because the Trade Center South building was located in the enterprise zone, and the taxpayer was located within the enterprise zone, that no sales tax was due. (Tr. pp. 9-11)

18. On July 6, 1989, the taxpayer renewed its Reseller's Certificate of Registration with the Department. It was again renewed on July 6, 1992. (Taxpayer's Ex. No. 3(a) and (b))

19. The Department issued Enterprise Zone Informational Bulletin FY 87-28E in January 1987 to "Building-Materials Retailers Located Within the City of Champaign or the Unincorporated Area of Champaign County" to explain and clarify what determined the eligibility for the enterprise zone exemption. (Taxpayer's Ex. No. 4)

20. On June 15, 1990, a letter was issued to Senator Stanley Weaver of Urbana, Illinois, by Roger Sweet, then Director of the Department, explaining that for purposes of the Retailer's Occupation Tax Act and related tax acts, construction contractors (including subcontractors) are deemed to be the users of the building materials which they purchase for permanent incorporation into real estate. [cites omitted] (Taxpayer Ex. No. 5)

21. In early 1995, the taxpayer hired the certified public accounting (CPA) firm of Martin, Hood and Associates because they were being audited by the Department and that particular firm had experience dealing with the issue of enterprise zone exemptions and construction contractors. (Tr. pp. 31-33)

22. Other construction contractors and certified public accountants in the Champaign/Urbana area had experienced similar problems with the interpretation of the exemption. (Tr. pp. 33-34)

23. The CPA firm obtained Exhibits 4 through 8 in order to understand what was being distributed to the community and relied upon by taxpayers in the interpretation of the enterprise zone exemption. (Tr. pp. 34-38)

24. The CPA firm clarified the issue with the taxpayer and helped them to establish procedures to use the enterprise zone exemption correctly. (Tr. pp. 14, 38-39)

25. Prior to hiring the CPA firm, the taxpayer relied upon information gathered from other contractors, the City of Champaign and the specifications for the projects for its interpretation of the enterprise zone exemption. (Tr. pp. 6-8, 10, 12-17)

Conclusions of Law:

Both the Retailer's Occupation Tax Act and the Use Tax Act have an exemption for sales of building materials to be incorporated into real estate in an enterprise zone by remodeling, rehabilitation or new construction. *See* 35 **ILCS** 120/5k and 35 **ILCS** 105/3-65.

The Department has promulgated rules, pursuant to the statutory authority found at 5 **ILCS** 100/5-10 and 35 **ILCS** 120/12. Regarding sales to Construction Contractors, Real Estate Developers and Speculative Builders, found at 86 Admin. Code ch. I, Sec. 130.2075, is the information that persons who sell tools, equipment and building materials to construction contractors incur Retailer's Occupation Tax liabilities. This Section is used in conjunction with 86 Admin. Code ch. I, Sec. 130.1940, which defines what is a construction contractor and real estate developer. The Section is a codification of case law, in particular Lyon & Sons Co. v Revenue Dept., 23 Ill.2d 180 (1961), Material Services Corp. v. Issacs, 25 Ill.2d 137 (1962)

The taxpayer is in the business of construction. As a construction contractor, the law is very clear that the contractor's incorporation of building materials into real estate is an end use of the materials by the contractor and

not a sale or use of the materials to the contractor's customer. Craftmasters, Inc. v. Department of Revenue, 269 Ill.App.3d 934 (4th Dist. 1995) The distinction that the taxpayer's attorney submits in her brief, that because the taxpayer did not physically incorporate the steel into the building, the taxpayer is not the end user of the materials is, I find, a matter of form over substance. The taxpayer was responsible for the installation and was responsible for making sure that the steel was installed properly.

There was no sale of materials to TAXPAYER Contractors and sale is the operative word in the statute. It is not the question of who is the end-user of the tangible personal property, as the attorney for the taxpayer argues. The statute states:

> § 5k. Each retailer whose place of business is within a county or municipality which has established an Enterprise Zone pursuant to the "Illinois Enterprise Zone Act" and who **makes a sale of** building materials to be incorporated into real estate in such enterprise zone by remodeling,... may deduct receipts from such sales when calculating the tax imposed by this Act. (35 **ILCS** 120/5k, incorporated into the Use Tax Act at 35 **ILCS** 105/3-65) (emphasis added)

The taxpayer admitted that they purchased the raw materials from Ozark Steel or another distributor who was not located within the enterprise zone. I therefore find that the use tax assessment by the auditor was properly determined.

The next assertion by the taxpayer, that they should not be liable for the penalties imposed, I find is supported by the facts of record. The taxpayer was registered with the Department with a reseller's certificate. He gave resale certificates to Ozark Steel, under the mistaken belief that the sales were tax exempt. I personally have had more than one case with this same issue and area involved. While the case law is clear, that the Department's position that the contractor is the end user of the materials in incorporating them into the real estate, is correct, Craftmaster's was not decided until 1995. The transaction at issue took place in 1989.

The Department, until 1994 and the enactment of the Uniform Penalty and Interest Act, found at 35 **ILCS** 735/3-1 *et seq.*, had not promulgated rules regarding what is considered to be reasonable cause for an abatement of penalties. However, with the enactment of the Act, the Department also provided guidelines as to what could be considered reasonable cause. The guidelines are found at 86 Ill. Admin. Code ch I, Sec. 700.400 and state:

a) (Section 3-8 of the Act)

b) The determination of whether a taxpayer acted with reasonable cause shall be made on a case by case basis taking into account all pertinent facts and circumstances. The most important factor to be considered in making a determination to abate a penalty will be the extent to which the taxpayer made a good faith effort to determine his proper tax liability and to file and pay his proper liability in a timely fashion.

c) A taxpayer will be considered to have made a good faith effort to determine and file and pay his proper tax liability if he exercised ordinary business care and prudence in doing so. A determination of whether a taxpayer exercised ordinary business care and prudence is dependent upon the clarity of the law or its interpretation and the taxpayer's experience, knowledge, and education. Accordingly, reliance on the advice of a professional does not necessarily establish that a taxpayer exercised ordinary business care and prudence, nor does reliance on incorrect facts such as an erroneous information return.

d) The Department will also consider a taxpayer's filing history in determining whether the taxpayer acted in good faith in determining and paying his tax liability. Isolated computational or transcriptional errors will not generally indicate a lack of good faith in the preparation of a taxpayer's return.

e) Examples of Reasonable Cause. The following non-exclusive list of situations will constitute reasonable cause for purposes of the abatement of penalties:

1) Reasonable cause for abatement of penalty will exist if a liability results from amendments made by the Department to regulations or formal administrative policies or positions after the return on which the liability was computed was filed.

2) Reasonable cause for abatement may also be based on the death, incapacity or serious illness of the taxpayer (or his tax preparer) or a death or serious illness in his or her immediate family which causes a late filing and payment of tax due....

3) An unavoidable absence of a tax payer (or tax preparer) due to circumstances unforeseeable by a reasonable person may also constitute reasonable cause for purposes of abatement of the

penalty. An unavoidable absence does not include a planned absence such as a vacation. In the case of a corporation, estate, trust, etc., the absence must have been of an individual having sole authority to file the return (not the individual preparing the return) or make the deposit/payment.

4) Factors beyond taxpayer's control such as destruction by fire, other casualty or civil disturbance, of the taxpayer residence or place of business records.

5) Taxpayer mailed the return or payment to the Department in time to reach the Department on or before the due date, given the normal handling of the mail. However, through no fault of the taxpayer, the return or payment was not delivered within the prescribed time period. This fact situation would constitute reasonable cause for abatement of the penalty.

6) Reasonable cause will exist for purposes of abatement of the penalty if a taxpayer makes an honest mistake, such as inadvertently mailing a Department of Revenue check to a local government, another state's Department of Revenue, or the Internal Revenue Service.

7) An Illinois appellate court decision, a U.S. appellate court decision, or an appellate court decision from another state (provided that the appellate court case in the other state is based upon substantially similar statutory or regulatory law) which supports the taxpayer's position will ordinarily provide a basis for a reasonable cause determination.

I find that the taxpayer has established that his mistaken belief that he was a retailer and was justifiable for the purposes of a reasonable cause abatement of the penalties. I do believe his testimony that he could have passed the tax on to 51 Associates, by way of the negotiated contract, if he had known it was due. His testimony was certainly credible regarding the lack of knowledge prior to the hiring of the CPA firm in 1995. While ignorance of the law is no defense, I feel that given the circumstances of the confusion regarding the enterprize zone exemption in Champaign County and the confusing information sent by the City of Champaign-Champaign County Enterprise Zone, as well as the fact that Craftmaster's was not decided until 1995, is sufficient to establish that an abatement of penalties is warranted in this matter.

Regarding the assertion that the interest charged in this matter does not follow the Internal Revenue Standards, the interest charged is statutory and there is no provision for a change of that interest rate in the statute. I

therefore find that the interest rate charged by the Department shall stand as issued.

Respectfully Submitted,

_____

Barbara S. Rowe
Administrative Law Judge

June 18, 1997